No. 15887

In the United States Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

BELRIDGE OIL COMPANY, RESPONDENT

On Petition For Review Of the Decision Of the Tax Court Of the United States

BRIEF FOR THE PETITIONER

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CITATIONS

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OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 79-104) are reported at 27 T. C. 1044.

JURISDICTION

This petition for review (R. 113-117) involves federal income and excess profits taxes for the taxable year 1950. On May 28, 1954, the Commissioner of Internal Revenue mailed to taxpayer a notice of a deficiency in the total amount of $43,746.32 (R. 21-26.) Within 90 days thereafter and on August 18, 1954, the taxpayer filed a petition for a redetermination of that deficiency under the provisions of

Section 272 of the Internal Revenue Code of 1939. (R. 3, 5-34.) The decision of the Tax Court was entered on July 26, 1957. (R. 112.) The case is brought to this Court by a petition for review filed October 18, 1957. (R. 113-117.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

The taxpayer was the owner of fee interests in two separate depletable parcels of land from which oil and gas were being produced from two or more depths or zones, including one, called the 64 Zone, which also underlay properties belonging to other oil companies. Effective as of February 1, 1950, the taxpayer and five other oil companies entered into an agreement for the unitized production of oil and gas from 64 Zone on a cooperative basis, under which the taxpayer's participating share was 71.87 percent of the production from the entire zone.

The question presented is whether in entering into this unitization project the taxpayer created a new interest on which it must compute its depletion allowance as to 64 Zone, under Sections 23(m) and 114(b)(3) of the Internal Revenue Code of 1939, as the Commissioner contends, or whether, as the Tax Court held, the taxpayer continued to have only two separate interests for depletion purposes.

STATUTES AND REGULATIONS INVOLVED

The relevant portions of the statutes and Regulations involved are set forth in Appendix A, *infra*.

STATEMENT

The stipulated facts (R. 38-51) and the findings of fact made by the Tax Court (R. 82-96) may be summarized as follows:

The taxpayer is a California corporation which has been engaged for many years in the business of producing oil and gas. In 1911 it acquired fee simple ownership of 30,845.96 acres of land, known as the "Main Property," on which two separate oil and gas production fields, known as the North and South Belridge fields were developed. On September 1, 1944, the taxpayer purchased the working interest and the landowners' and royalty owners' rights in a producing property known as the Result Property, consisting of 80 acres adjacent to the North Belridge field. (R. 82.)

Prior to 1950, the taxpayer had completely recovered its tax basis for its Main Property through cost depletion allowances and therefore computed its allowable depletion deduction by the percentage depletion method. On the Result Property the depletion allowance based upon adjusted cost has been consistently greater than the percentage depletion allowance. On its tax return for 1950, therefore, the taxpayer claimed cost depletion on its Result Property and percentage depletion on its Main Property, as it had done in previous years. (R. 93-94.)

There are five different depths or zones from which oil and gas are produced from the North Belridge field: the Shallow Zone (which produces from relatively shallow depths), the Temblor Zone (approxi-

mate depth—6,000 feet), the R. Zone (approximate depth—7,000 feet), the 64 Zone (approximate depth—8,000 feet) and the Y. Zone (approximate depth—9,000 feet). The 64 Zone and the Temblor Zone also underlie portions of the taxpayer's Result Property. (R. 82-83.)

The 64 Zone is the largest developed oil and gas reservoir underlying taxpayer's Main and Result Properties. This zone also underlies portions of adjacent and nearby land owned or operated by five other oil companies. The gas cap of the 64 Zone is located principally under the taxpayer's land and, by lessening or increasing gas cap pressure, oil can be moved up or down structure from the taxpayer's land. Prior to October, 1941, production by all companies operating in the 64 Zone was entirely on a competitive basis. Oil production from the 64 Zone reached approximately 12,000 barrels a day by 1938, but after 1938 the reservoir pressure and oil production from the zone steadily declined. From October, 1941, to April 1, 1947, a voluntary gas pressure maintenance program, whereunder a portion of the gas produced from the zone was returned to the reservoir, was put into effect by the companies producing from the zone. During the period from April 1, 1947, until February 1, 1950, the six companies producing from the 64 Zone abandoned this program and resumed unrestricted competitive production. (R. 83.)

On July 1, 1949, the taxpayer and the five other companies producing from the 64 Zone entered into a unitization agreement providing for production of oil

and gas from the zone on a cooperative basis. Generally speaking, the agreement, which became effective on February 1, 1950, provided that, as to 64 Zone oil, development and operation of the properties of the six participants was to be conducted on a cooperative basis by a designated operator and that each participant was to receive a specified percentage of all the oil, gas and associated hydrocarbons produced. (R. 84.) The major portion of the agreement (Stip. Ex. 3-C, R. 39) is printed in Appendix B. *infra*.[1]

Each of the participants in the unitization agreement had "Participating Equities" as follows (R. 91):

Participant	Participating Equity and Tract Value Assigned
Belridge Oil Company	71.87%
Tide Water Associated Oil Company	16.58%
Richfield Oil Corporation	4.44%
The Texas Company	4.44%
Standard Oil Company of California	1.48%
Union Oil Company of California	1.19%

The taxpayer, Tide Water, Richfield and Standard had fee simple ownership of the tracts contributed by them to the unitization project. Union Oil Company also owned one of the three tracts which it contributed to the project in fee. The other two tracts

[1] Copies of Exhibit 3-C, the unitization agreement, and of Exhibit 4-D, a supplemental agreement relating to accounting procedure, have also been furnished the Court by taxpayer.

held by Union were held under leases as were the tracts of the Texas Company. (R. 91.) The participating equities allotted to each of the companies approximated the percentages of the total production from the 64 Zone which each had obtained during the period of unrestricted competitive production which immediately preceded the effective date of the agreement. (R. 91-92.)

Consents to the agreement were exercised by a number of the lessors and royalty owners who had interests in the 64 Zone covered by leases held by the Texas Company and Union Oil. The other participating companies (the taxpayer, Tide Water, Richfield and Standard), who together owned in fee 92 percent of the land covered by the agreement, did not execute lessors' and royalty owners' consents. (R. 92-93.)

The portions of taxpayers' two properties which were affected by the unitization agreement were the 64 Zone underlying its Result Property and the 64 Zone underlying some, but not all, of its Main Property. The agreement did not affect any of the other zones underlying the taxpayer's land; taxpayer and the other five participating companies continued to operate and produce from one or more of the other zones underlying the surface area of their respective properties covered by the agreement. The taxpayer took no production from the Temblor Zone of its Result Property during the years 1949 to 1953, inclusive, but in 1954 it resumed production from that zone. (R. 92-93.)

Under the unitized operation in 1950 (February 1 through December 31) a total of 428,139 barrels of oil were produced from the 64 Zone. Of this amount, 21,672 barrels were produced from wells located on taxpayer's Result Property, 215,390 barrels were produced from wells located on its Main Property and 191,077 barrels were produced from wells located on the property of other participants. The taxpayer's 71.87 percent share of production under the unitization agreement was 307,704 barrels, or 70,642 barrels more than that produced from wells located on its property. (R. 93.)

The taxpayer, on its tax return for 1950, claimed cost depletion on its Result Property and percentage depletion on its Main Property, as it had done in previous years, and allocated its unitized share of 64 Zone oil to the two properties. (R. 94.) The Commissioner determined that by virtue of the unitization agreement the taxpayer had a single depletable interest in the unitized 64 Zone and that the statutory percentage depletion allowance computed thereon would give taxpayer the maximum allowable deduction for depletion. (R. 95-96.) The Tax Court held that taxpayer retained its original separate depletable interests in 64 Zone oil. (R. 96-104.)

STATEMENT OF POINTS TO BE URGED

The points urged by the Commissioner are detailed in our Statement of Points (R. 117-120.) Briefly, it is the Commissioner's position that the Tax Court erred in holding that the unitization agreement did

not create a new, separate and single depletable interest in respect of taxpayer's share of unitized 64 Zone oil.

SUMMARY OF ARGUMENT

For depletion purposes under Sections 23(m) and 114 (b)(3) of the Internal Revenue Code of 1939, the taxpayer's contribution of its interest in the 64 Zone of oil and gas, underlying its Main and Result Properties, into a unitization project entered into with the five other companies which had working interests in the 64 Zone, in return for a 71.87 percent share of production from the entire unitized zone, resulted in the creation of a new, separate and single interest in respect of 64 Zone oil. Under the Code and Regulations the depletion allowance is made with respect to each separate "property", defined in the Regulations as the interest owned by the taxpayer in each separate "mineral property", which in turn is defined in such a way as to mean an operating or production unit. Thus "property" for depletion purposes means any depletable interest in a production unit. An interest in a unitization project is a substantially different interest from other types of oil interests and is therefore a separate "property" for depletion purposes.

The unitization agreement involved here clearly created a separate operating unit and separate interests therein as to 64 Zone oil. The oil from the zone was produced, and treated for accounting purposes, on a unit basis. All of the expenses of production of oil from the zone were shared by the partici-

pants in proportion to their shares of production and the participants owned the equipment and facilities of the unit project as tenants in common. Each participant was entitled to receive a percentage share of the total oil produced by the unit. Although each participant was free to develop and produce oil from other zones or strata on its own land, the unitized interest in the 64 Zone was carved out and treated as a separate transferable interest. The taxpayer, after entering into the unitization agreement, could no longer produce separately from the 64 Zone underlying its land. Its only interest in 64 Zone was a unitized percentage interest—in all of the 64 Zone oil and in its production on a unitized basis—and it was only that interest which taxpayer could transfer to others. That interest, moreover, was created to endure so long as oil and gas could be economically produced from the zone, or until all parties, by unanimous agreement, chose to abandon the project.

In view of all this, the Tax Court's holding that the unitization agreement did not create a new, separate and single depletable interest, and that taxpayer may allocate its unitized share of 64 Zone oil to its Main and Result Properties, is both unrealistic and formalistic. Indeed, after the instant case, the Tax Court itself recognized that unitization can result in the creation of a new and different economic or depletable interest. In failing to hold that a new and separate depletable interest was created by the instant unitization agreement, the Tax Court erred and should be reversed.

ARGUMENT

For Depletion Purposes Under Sections 23(m) and 114(b)(3) Of the Internal Revenue Code of 1939, the Unitization Agreement Created a New, Separate and Single Interest In Respect of Taxpayer's Share Of 64 Zone Oil.

No question is here presented as to the taxpayer's right to a depletion deduction on 64 Zone oil; the inquiry is merely as to the amount of that deduction and, more specifically, as to the unit basis for its computation. The taxpayer was the fee owner of two tracts of land, one called the "Main Property" and the other the "Result Property." Prior to 1950, the taxable year, the taxpayer produced oil and gas from the various zones (including 64 Zone) underlying the Main and Result Properties, which were concededly separate properties for depletion purposes. In 1950, however, the taxpayer contributed its interest in one of the zones underlying both properties, 64 Zone, to a unitization project entered into with the five other oil companies who had working interests in adjoining land from which they too produced from 64 Zone. In return, taxpayer received a 71.87 percent share of the production from the entire unitized zone. Despite the unitization of the 64 Zone oil, the Tax Court held that taxpayer is entitled to allocate part of its unitized oil to its Main Property, on which it took *percentage* depletion, and the other part to the Result Property, on which it took *cost* depletion.[2] It is

[2] Taxpayer is claiming cost depletion on a part of the unitized oil because, as the Tax Court stated (R. 98), the result is a higher depletion deduction than if percentage depletion is taken on all of the unitized oil.

our contention that, as to the 64 Zone oil, the unitization agreement created an additional, new, separate and single depletable interest, so that taxpayer must compute its depletion on its 71.87 percent share of production from the unitized 64 Zone as one depletable interest.[3]

In Section 23(m) of the Internal Revenue Code of 1939 (Appendix A, *infra*), Congress has authorized the deduction, in the case of mines, oil and gas wells, and other natural deposits, of—

> a reasonable allowance for depletion * * * according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

Section 114(b)(1) of the Code entitled "General rule" and having reference to *cost* depletion, provides for depletion on the adjusted basis in respect of any "property". Section 114(b)(3) (Appendix A, *infra*) authorizes *percentage* depletion, in the case of oil and gas wells, of 27½ percent of the gross income from the "property" (not to exceed 50 percent of net income). Each separate "property" is a separate depletable unit (Treasury Regulations, Section 29.23(m)-1(i) (Appendix A, *infra*); Breeding and Burton, Taxation of Oil and Gas Income (1954), p. 117) but the word "property" is not here used in the ordinary sense. For tax purposes, the

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[3] We, of course, concede that the Main and Result Properties are separate depletable properties as to the oil produced therefrom other than 64 Zone oil.

fee ownership of land (as related to oil production) and each of the various kinds of oil interests (e.g., leasehold and royalty interests) have significance only as property constituting as "economic interest" in the oil in place, a term which is synonymous with a depletable interest and means an interest from which the receipt of profit depends solely upon the production of oil in which the owner of the interest is deemed to have his capital investment. See, e.g., *Kirby Petroleum Co.* v. *Commissioner*, 326 U. S. 599; *Burton-Sutton Oil Co.* v. *Commissioner*, 328 U. S. 25. Thus, for the purposes of the depletion deduction the word "property" is defined in Treasury Regulations 111, Sections 29.23(m)-1(b), (c) and (i), as meaning "the *interest* owned by the taxpayer * * * in each separate mineral property" (italics supplied) and "mineral property" is defined as "the mineral deposit [meaning "minerals in place"], the development and plant necessary for its extraction, and so much of the surface of the land only as is necessary for purposes of mineral extraction." Accordingly, "each separate interest owned by the taxpayer in each separate tract or parcel of land" is a separate depletable unit.[4] G.C.M. 24094, 1944 Cum. Bull. 250, 252.

It is apparent, therefore, that for depletion purposes as related to oil and gas production, "property" means any depletable "interest" in oil production. There are many established types of depletable oil

[4] This definition has been adopted by Congress in Section 614(a) of the Internal Revenue Code of 1954.

interests, such as a fee, leasehold, royalty, and net profits interest and an oil payment right. See, e.g., *Palmer* v. *Bender*, 287 U. S. 551; *Kirby Petroleum Co.* v. *Commissioner*, 326 U. S. 599; *Burton-Sutton Oil Co.* v. *Commissioner*, 328 U. S. 25; *Thomas* v. *Perkins*, 301 U. S. 655. As to the very same operation, usually by fee or leasehold owners, the owners of any one of these various interests have a separate depletable interest or "property". *Id.; Helvering* v. *Jewel Mining Co.*, 126 F. 2d 1011 (C. A. 8th). While some of the recognized depletable interests are quite similar, such as a royalty interest and an oil payment right (see *Anderson* v. *Helvering*, 310 U. S. 404, 409-410), the similarity of the interests does not make them any the less separate and distinct "property" for depletion purposes. A unitized interest differs from all other types of oil interests and is therefore also separate "property" for depletion purposes.

It should particularly be noted that each interest in a *separate operating unit* is a separate "property." As already shown, it is each interest in a "mineral property" which is a separate interest or "property", and "mineral property" is defined as meaning the minerals in place, the development and plant necessary for its extraction and so much of the surface of the land as is necessary for mineral extraction. This definition plainly contains the essentials to an operating unit of production. Thus, it is the operating unit which furnishes the basis for separation of the various types of depletable interests or "property." For example, tracts of land which are not contiguous geographically are treated as separate properties for de-

pletion purposes. See *Vinton Petroleum Co.* v. *Commissioner*, 71 F. 2d 420 (C. A. 5th), certiorari denied, 293 U. S. 601, rehearing denied, 293 U. S. 633. Similarly, each leasehold operation is a separate operating unit, to which other depletable interests may attach. For instance, although a single individual has several interests of the very same type, for example royalty interests, which attach to separate leasehold operating units, each interest is a separate depletable interest or "property."

In the present case we are concerned with a relatively new type of oil interest, a unitized interest. It is beyond dispute that the unitization agreement (Ex. 3-C, Appendix B, *infra*) created a *separate operating unit* as to the 64 Zone oil. Indeed, that is the very purpose of unitization, as even the Tax Court seems to have recognized. (R. 100). As the Fifth Circuit stated in *Campbell* v. *Fields*, 229 F. 2d 197, 199:

> Unitization * * * represents development and operation of an oil pool as a unit. It involves the consolidation and merger of all of the interests in the pool and designation of one or more of the parties as operator. * * *

In the instant case taxpayer and five other oil companies joined together in a unitization agreement with respect to the production of 64 Zone oil underlying the properties of all participants. Under the agreement the 64 Zone oil was produced, and treated for accounting purposes, on a unit basis. (Ex. 3-C, Arts. II and III.) Separate equipment and facilities were used for the unit project and each participant not only paid its proportionate share of the expenses of

production but owned the equipment and facilities as a tenant in common with the others. (Ex. 3-C, Arts. V and VII.) Each participant was free to separately develop and produce oil from other formations or zones on its own land (Ex. 3-C, Art. IX), but the unitized interest of each was treated as a separate, transferable interest (Ex. 3-C, Art. XI).

Although the Tax Court did not think so, it is also clear that taxpayer's *interest* in the 64 Zone oil was different after unitization. Before unitization taxpayer's interest was in all the 64 Zone oil in place underlying, or which could be produced from operations on, its Main and Result Properties. After unitization taxpayer had a 71.87 percent interest in all of the 64 Zone oil in place which underlay or could be produced from the unitized operations on not only its own property but that of the other five oil companies. The difference, merely from the standpoint of quantum, is vividly portrayed by the fact that, although only 237,062 barrels of oil were produced from wells located on taxpayer's land under unitized operations in 1950, taxpayer's share of the unitized oil was 307,704 barrels. (R. 93.) No longer could taxpayer produce oil from 64 Zone on its own and with its own equipment. Instead, with benefits to itself obviously in mind, it became the owner, as a tenant in common, of the equipment used in the unitized operation and gave up its rights of production from its own land for a unitized interest in production from the lands of all participants. No longer could taxpayer transfer any interest with respect to 64 Zone other than its unitized interest, which, as

already stated, was a separate, transferable interest. That interest was also an enduring one, for the unitization agreement was to remain in full force and effect as long as oil and gas could be produced from 64 Zone in sufficient quantities to pay the costs of production, unless the agreement was previously terminated by the *unanimous* consent of all participants. (Ex. 3-C, Art. XII, Sec. 2.) Each participant could sell, assign, transfer or otherwise dispose of its interest in the *land* involved but only subject to the unitization agreement (Ex. 3-C, Art. XI, Sec. 2), just as leasehold owners may transfer their interests subject to outstanding royalty and other interests. Clearly, the unitization agreement created a new, separate and single depletable unit consisting of a unitized interest in 64 Zone oil.

The Tax Court's holding to the contrary seems to have been based on two premises which are irrelevant. First, the Tax Court specifically rejected the Commissioner's argument that the unitization agreement resulted in an "exchange" by taxpayer of property of like kind within the meaning of Section 112(b)(1) (26 U. S. C. 1952 ed., Sec. 112). (R. 98-100.) But the Tax Court's rejection of that argument was on the technical ground that the unitization agreement "discloses no words of conveyance". (R. 99.) Actually, it is immaterial whether the unitization agreement resulted in a technical "exchange" of property by this taxpayer, and the Commissioner did not so limit his argument in the Tax Court.[5] Precise char-

[5] It was our position in the Tax Court, as here, that as to the 64 Zone oil the unitization agreement created a new,

acterization of the nature of the unitization transaction as to this taxpayer is unnecessary so long as the transaction resulted in the creation of a new, separate and single depletable interest. As the Supreme Court stated in *Palmer* v. *Bender*, 287 U. S. 551, 557, the depletion statutes apply to—

> every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, *by any form of legal relationship*, income derived from the extraction of the oil, to which he must look for a return of his capital. * * * (Italics supplied)

For example, the execution of an oil and gas lease by a landowner for a lump sum consideration and future payments from production amounting to a royalty interest, as in *Burnet* v. *Harmel*, 287 U. S. 103, creates a new depletable interest (the royalty interest) even though, as the Supreme Court expressly held in the *Harmel* case, the transaction is not a sale or exchange of property. The tax statutes

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separate and single depletable interest, so that taxpayer must compute its depletion on its 71.87 percent share of production from the unitized 64 Zone as one depletable interest (See e.g., R. 57, 58, 59, 64), and that position included a contention that there was a "merger" of interests as to 64 Zone oil. (R. 58, 64.) Lest taxpayer conceive our abandonment of the "exchange" theory and our present argument as a new argument, we call the Court's attention to the fact that the main argument in our Tax Court brief (pp. 23-30) was under the following heading (p. 23): "Under the unitization agreement, petitioner's separate operating interests in the 64 Zone were, in substance and effect, merged, consolidated, or exchanged for a single depletable property interest."

covering sales and exchanges of property have reference to property constituting a capital asset and the retention of an economic interest in the oil and gas in place precludes a sale or exchange of such property, as in *Harmel*. But that does not preclude recognition of the effect of the transaction as creating a new interest, here, any more than in *Harmel* and other decisions of the Supreme Court involving the execution or so-called sales of oil and gas leases.

The Tax Court also stated (R. 100-101) that the "net effect" of the unitization agreement was a "joint effort" by the participants to "conserve" their respective "individual interests" by joining in a plan which left each with "exactly the same interests and rights in its respective properties after unitization as before" except that by mutual consent they had agreed to limit their production and operate their wells in the most economically feasible way. Since, as we have already shown, the unitization agreement clearly changed the participants' interests in and with respect to 64 Zone oil—even to the extent of giving them a new, separate, single, transferable and enduring property right—the Tax Court must have been thinking in some such terms as that the unitization did not effect a conversion of taxpayer's capital investment in 64 Zone oil.

While a capital investment in the oil in place is one of the two essentials to an "economic" (or depletable) interest (*Commissioner* v. *Southwest Expl. Co.*, 350 U. S. 308), a conversion of the capital investment is not necessary to create a new and different depletable interest. Indeed, it is precisely be-

cause of a taxpayer's *original* investment that he is deemed to have a *depletable* interest when by some transaction, such as the execution or transfer of a lease, he *creates and retains* a *new* type of interest, such as a royalty interest. See *Commissioner* v. *Southwest Expl. Co.*, *supra*, pp. 314-315; *Palmer* v. *Bender*, 287 U. S. 551, 558; *Burton-Sutton Oil Co.* v. *Commissioner*, 328 U. S. 25, 33-35. The original capital investment supports, rather than refutes, the conclusion that the new interest is a separate depletable interest.

The only important fact here, under the pertinent statutes and Regulations, is that unitization created a new and different type of interest in 64 Zone oil and in a new and different operating or production unit. Once different types of interests are created, they remain separate depletable interests so long as all of those interests are not merged to become identical to some larger interest. *Badger Oil Co.* v. *Commissioner*, 118 F. 2d 791 (C.A. 5th).

The Tax Court's decision in this case is unrealistic, not only as to the effect of the unitization agreement in respect of taxpayer's interest in 64 Zone oil but as related to the mechanics of computing taxpayer's depletion deduction on 64 Zone oil. The Tax Court would permit taxpayer to compute depletion on its unitized share of 64 Zone oil as if that oil were produced from taxpayer's own two properties, its Main and Result Properties, on one of which taxpayer takes percentage depletion and on the other of which it takes cost depletion. Actually, from February 1 to December 31, 1950, the unitized operations resulted

in the production of some 21,672 barrels of oil from wells located on taxpayer's Result Property (R. 93) but of course taxpayer's interest was not in that particular oil; it was in a stated percentage of the 64 Zone oil produced from all of the participants' properties. Thus, the Tax Court would permit taxpayer to allocate a lesser portion of its unitized oil (11,859 barrels) to the Result Property than the actual amount produced from that property. (R. 101-104.) This means, among other things, that taxpayer may be able to continue taking cost depletion on the Result Property long after the estimated reserves of 64 Zone oil on that property are exhausted. It also means that the Tax Court has not only permitted resort to an allocation of oil but has allowed the oil from one separate operating unit to be allocated to other operating units, whereas the very nature and separateness of taxpayer's unitized interest affords a simple and much more realistic basis for computing taxpayer's depletion deduction with respect to 64 Zone oil.

There is nothing new or novel in our position that, as to the 64 Zone oil, the unitization agreement resulted in the creation of a new, separate and single depletable interest. Although unitization is relatively new, some writers have already recognized that mineral interests may be classified as separate on the basis of unitization. See, e.g., P-H Oil and Gas, Taxes, p. 4019; Arthur Anderson & Co. Oil and Gas, Federal Income Tax Manual, p. 85. As a matter of fact, the Tax Court itself recognized, subsequent to its decision in the present case, that a new depletable interest can be created by virtue of a unitization

agreement. See *Whitwell* v. *Commissioner*, 28 T. C. 372, now pending on appeal to the Fifth Circuit.

Campbell v. *Fields*, *supra*, on which taxpayer relied in the Tax Court, is not in point. While it is the only tax case decided by a Court of Appeals involving a unitization situation, it did not present any question as to the tax effects of entering into a unitized project for the development of an oil and gas field. It involved the issue whether legal fees incurred in the formation of the project were deductible as ordinary and necessary business expenses.

Taxpayer's 71.87 percent unitized interest in production from the entire 64 Zone is, we submit, a separate property for depletion purposes. The Tax Court erred in holding to the contrary.

CONCLUSION

For the reasons stated, the decision of the Tax Court should be reversed.

Respectfully submitted,

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APPENDIX A

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

* * * *

(26 U. S. C. 1952 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * *

(b) *Basis for Depletion.*—

* * * *

(3) *Percentage depletion for oil and gas wells.*—In the case of oil and gas wells the allowance for depletion under Section 23 (m) shall be 27½ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of

the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23(m) be less than it would be if computed without reference to this paragraph.

* * * *

(26 U. S. C. 1952 ed., Sec. 114.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.23(m)-1. DEPLETION OF MINES, OIL AND GAS WELLS, OTHER NATURAL DEPOSITS, AND TIMBER; DEPRECIATION OF IMPROVEMENTS.—

* * * *

When used in these sections (29.23(m)-1 to 29.23(m)-28, inclusive) covering depletion and depreciation—

* * * *

(b) A "mineral property" is the mineral deposit, the development and plant necessary for its extraction, and so much of the surface of the land only as is necessary for purposes of mineral extraction. The value of a mineral property is the combined value of its component parts.

(c) The term "mineral deposit" refers to minerals in place. The cost of a mineral deposit is that proportion of the total cost of the mineral property which the value of the deposit bears to the value of the property at the time of its purchase.

* * * *

(i) "The property," as used in section 114 (b) (2), (3), and (4) and sections 29.23(m)-1 to 29.23(m)-19, inclusive, means the interest owned by the taxpayer in any mineral property. The taxpayer's interest in each separate mineral property is a separate "property"; but, where two or more mineral properties are included in a single tract or parcel of land, the taxpayer's interest in such mineral properties may be considered to be a single "property," provided such treatment is consistently followed.

APPENDIX B

EXHIBIT 3-C

Unit Agreement For the 64 Zone Of the North Belridge Oil and Gas Field, Kern County, California

ARTICLE I

Definitions

Section 1. The following definitions shall apply to the following terms as employed in this agreement:

* * * *

(c) UNITIZED SUBSTANCES shall mean all oil, gas and associated hydrocarbons produced and saved from the 64 Zone pursuant to this agreement.

* * * *

(e) PARTICIPANT shall mean an owner at the date of this agreement, and each successor, assignee or transferee of such owner, of the right to develop and operate lands within the Area and to produce Unitized Substances, whether as lessee or otherwise, and shall include the owner of such lands not under lease as well as the lessee of such lands under lease.

* * * *

(g) TRACT VALUE shall mean that percentage which is the share of the Unitized Substances allocated under this agreement to each respective tract of land within the Area.

(h) PARTICIPATING EQUITY shall mean that percentage which is the share of the Unitized Substances allocated under this agreement to each respective Participant.

(i) OPERATOR shall mean the person, firm or corporation selected as provided in this agreement to act as operator for Participants under this agreement, including not only the original Operator named in this agreement but each and every successor Operator selected as provided in this agreement.

(j) UNIT OPERATION shall mean the development and operation of the 64 Zone pursuant to this agreement and the conduct of such other operations as herein provided for.

(k) UNIT WELLS shall mean all wells (except wells drilled for the purpose of producing water only) in the possession of Operator under this agreement, whether acquired from Participants or drilled by Operator, and shall include necessary equipment, valves and controls for the operation thereof up to, but not including, the flow line connections of such wells and shall not include any well derricks.

(l) UNIT FACILITIES shall mean all pipe lines, crude oil flow lines, flow line connections, gague tanks, crude oil storage facilities, gas injection lines fom the discharge outlet of the Compressor Plant, pumps, pumping equipment and other tangible property (except Unitized Substances, Unit Wells, rented equipment and Operator's exclusively owned equipment) of every kind, nature and description in the possession of Operator under this agreement, whether acquired from Participants or purchased or constructed by Operator pursuant to this agreement.

* * * *

ARTICLE II

Unitization-Conservation

Section 1. The rights of Participants to develop and operate in and to produce from the 64 Zone oil, gas and associated hydrocarbons, and the oil, gas and associated hydrocarbons in the 64 Zone and produced therefrom, are hereby unitized, to the end that the 64 Zone shall be developed and operated as a unit by a single operator for the benefit of Participants. The Tract Values set forth in the table attached hereto marked Exhibit "B" are hereby allocated to the respective tracts of land shown therein. The Participating Equities set forth in the table attached hereto marked Exhibit "C" are hereby allocated to the respective Participants. The aggregate Tract Values of the lands of each Participant shall be equal, at all times, to the Participating Equity of such Participant, the aggregate Tract Values of all Participants shall be equal, at all times, to one hundred per cent (100%), and the aggregate Participating Equities of all Participants shall be equal, at all times, to one hundred per cent (100%).

Section 2. Operations hereunder shall be conducted in accordance with sound and efficient oil-field practices for the purpose of properly conserving the natural resources of the 64 Zone and endeavoring to obtain ultimately the maximum economic recovery of Unitized Substances.

Section 3. Except as provided in Articles IX and X hereof this agreement shall not apply to interests, rights or obligations in any formation, zone or stratum other than the 64 Zone. Each Participant reserves whatever rights it may have to develop and produce oil, gas, and associated hydrocarbons from any and all formations, zones or strata other than

the 64 Zone, and, subject to the provisions of Section 4 of Article IX hereof, the right to drill through the 64 Zone for the purpose of developing and producing from such other formations, zones and strata as lie below the 64 Zone. Each Participant also reserves whatever rights it may have to use and occupy the lands of such Participant in the Area for all purposes not inconsistent with this agreement. Any Participant exercising such rights mentioned in this Section 3 and Operator shall so conduct their respective operations as to interfere as little as practicable with the operations of the other. Each Participant also reserves the right, if such exists, to develop and produce, for its own account, water from its lands, in common with Operator.

ARTICLE III

Administration of Unit Operation

* * * *

Section 3. Participants have the right and power to and shall:

(a) Decide all matters relating to removal of any Operator and selection of any successor Operator.

(b) Determine the wells completed in the 64 Zone which are not required for the Unit Operation, pursuant to Section 2 of Article V.

(c) Determine the equipment and facilities which are or will be required for the Unit Operation, pursuant to Section 3 of Article V.

(d) Approve and adopt rearrangements or revisions of Exhibit "B" or Exhibit "C", or both, to the extent required or permitted by Section 4 of Article VII or by Article XI.

(e) Determine whether, when, how and where to drill additional Unit Wells.

(f) Determine all matters relating to major repair and maintenance of, and remedial work upon, Unit Wells, including dual zone wells.

(g) Determine all matters relating to the nature, size, location and method of operation of crude oil storage facilities and other arrangements for handling crude oil produced from the 64 Zone.

(h) Determine all matters relating to abandonment and dismantling of Unit Wells and Unit Facilities.

(i) Determine, at any time and from time to time, the measures which shall be adopted in order to endeavor to obtain ultimately the maximum economic recovery of Unitized Substances.

(j) Determine a plan and method for the control of pressure in the 64 Zone.

(k) Determine, from time to time, whether gas, water, and/or other substances shall be injected into the 64 Zone and the conditions and methods of injection, including the quantities thereof required to be injected to control pressure in such zone; and, if acquisition of additional gas, water, or other substances is determined to be advisable at any time for control of pressure, determine the amounts to be acquired and the terms and conditions upon which Operator shall be authorized to acquire and inject such additional gas, water, or other substances.

(l) Determine the Unit Wells which shall be used for injection purposes.

(m) Determine, on the basis of sound and efficient oil-field practices, rates of production of Unitized Substances.

(n) Determine the method of division of Unitized Substances among Participants in accordance with their Participating Equities in such manner that each Participant shall receive currently Unitized Substances of like quality and value as those received by each other Participant, and, to the extent that it is impracticable to make such division, determine a method for making periodic adjustments to equalize the division thereof among Participants as aforesaid.

(o) Approve or disapprove (1) Operator's estimates of costs and expenditures as provided in Section 10 of Article IV, and (2) any proposed expenditure of Operator (except those made pursuant to Section 7 or 9 of Article IV) for any item in excess of Fifteen Thousand Dollars ($15,000.00).

(p) Approve or disapprove the proposed sale or disposition of surplus Unit Facilities.

(q) Compromise or otherwise effect settlements of material overages and shortages at time of inventories.

(r) Determine the frequency, form and nature of reports to be prepared by Operator and submitted to Participants, in addition to those provided for in this agreement.

(s) Determine any other or additional matter required by any provision of this agreement or necessary or proper in accomplishing the objects and purposes of this agreement; provided that no determination under this Section 3 shall be made contrary to the provisions of this agreement.

* * * *

ARTICLE V

Transfers of Operating Rights and Other Property

Section 1. The initial Participants collectively are the owners on the date of this agreement of the right to develop and operate all lands within the Area and to produce Unitized Substances, and are the initial signatory parties to this agreement (exclusive of any exhibit hereto). At the effective time of this agreement Operator shall take exclusive possession of the operating rights of each Participant in and to the 64 Zone and enter into the performance of its duties hereunder; subject, however, to the right of each Participant to use and occupy its lands within the Area pursuant to Section 3 of Article II.

* * * *

Section 8. To the extent hereinafter in this Section 8 specified, each Participant indemnifies and agrees to hold harmless Operator and each other Participant from all loss, cost, or damage sustained by them, or any of them, as a result of any failure of title of such Participant to all or any portion of such Participant's right at the effective time of this agreement to develop and operate its lands or any thereof within the Area and to produce Unitized Substances, free and clear of the adverse interest of any person whomsoever. Such indemnity shall be limited to the amount of money Participants and/or Operator are obligated to pay and do pay to true owners of the right to produce oil, gas, natural gasoline, and associated hydrocarbons from the 64 Zone of such land as to which title has so failed, on account of such products actually produced in the course of the Unit Operation from wells located on such land, together with all costs and expenses, including reasonable attorneys' fees, incurred by Participants and/or Oper-

ator in connection with the defense against any such failure of title or claim thereof.

* * * *

ARTICLE VII

Ownership of Unitized Substances, Unit Wells and Unit Facilities; Participation; Payment of Costs and Expenses

Section 1. Each Participant shall own the percentage of Unitized Substances equal to the Participating Equity of such Participant.

Section 2. The Participants shall own, as tenants in common, all Unit Wells and Unit Facilities, and each Participant shall own an undivided interest in the Unit Wells and Unit Facilities equal to the Participating Equity of such Participant.

Section 3. In the event of changes in Participating Equities pursuant to Article XI, the ownership of each Participant in Unitized Substances, Unit Wells and Unit Facilities shall change correspondingly.

Section 4. There shall be allocated, as produced, to each numbered tract of land set forth in Exhibit "B", which is subject to this agreement at the time of production, the percentage of the total Unitized Substances produced and saved equal to the then Tract Value of such tract of land; provided, however, that such Unitized Substances as are lost by shrinkage or otherwise, or are used by Operator for fuel, gas lift, control of pressure, recycling, or other Unit Operations, or are lost by shrinkage or otherwise in the processing or removal of liquid products from wet gas allocated to Participants under this agreement, shall be excluded from such allocation and shall be royalty free. If any numbered tract of land set forth in Exhibit "B" is now or hereafter becomes divided

in ownership of Unitized Substances or Royalty Interest, or both, then, in the absence of an agreement between the interested parties determining the Tract Values of each segregated portion of such tract of land, the Tract Value shall be distributed to the segregated portions of such tract of land on a surface acreage basis, or if less than an entire numbered tract of land set forth in Exhibit "B" is excluded from this agreement as provided in Section 3 of Article XI, the Tract Value to be assigned to the portion of such tract of land remaining subject to this agreement shall be determined on a surface acreage basis.

Section 5. Except only as provided in Article XI, the Participants shall have no right or power to redetermine the Participating Equities of the Participants or the Tract Value assigned to any tract of land within the Area, and such Participating Equities and Tract Values shall not be changed, by reason of depletion of Unitized Substances, encroachment of water, evidence or proof of past, present or future nonproductivity, or for any other reason or in any other manner whatsoever, but Participants may divide or consolidate interests by transfers, assignments or other dispositions thereof, as provided in Article XI.

Section 6. Except as otherwise expressly provided in Section 2 of Article IX, each Participant shall bear and pay that part equal to its Participating Equity of all costs and expenses of the Unit Operation, including, but not by way of limitation, all costs and expenses of drilling, testing, completing, reworking, equipping and operating Unit Wells; all costs and expenses incurred in producing and saving Unitized Substances from Unit Wells; all costs and expenses incurred by Operator in planning, constructing, reconstructing, erecting, equipping, operating, main-

taining, repairing and enlarging Unit Facilities; and all costs and expenses of Operator authorized to be incurred by any provision of this agreement. Such costs and expenses, to the extent not paid in advance, shall be paid within twenty (20) days after receipt of statement from Operator, and, if not so paid, shall bear interest at the rate of seven per cent (7%) per annum. All such costs and expenses shall be accounted for in accordance with the Accounting Procedure.

ARTICLE VIII

Disposition of Unitized Substances

Section 1. Each Participant shall accept its share of the Unitized Substances (other than gas or other Unitized Substances used for injection or in operations hereunder) currently in kind as provided in this Article VIII.

Section 2. Each Participant shall take in kind its Participating Equity share of the crude oil produced and saved from the 64 Zone and delivered into the crude oil storage facilities and shall make all necessary arrangements with Operator to accept and shall accept delivery thereof from time to time upon demand of Operator. Such arrangements shall include a provision for the reimbursement of Operator for the cost of any service performed by Operator at the request of such Participant in connection with such delivery of crude oil. All crude oil shall, insofar as practicable, be divided among Participants in such manner that each Participant shall receive currently crude oil of like gravity and quality to that received by each other Participant; and, to the extent that such division is impracticable, a method for making periodic adjustments to equalize the division of crude oil among Participants as aforesaid shall be deter-

mined by Participants and placed in active operation by Operator.

* * * *

ARTICLE IX

Development of Other Zones; Default Notices

Section 1. Each Participant shall perform each and all the terms, covenants and conditions of any lease or other instrument under which such Participant is granted the right to develop and operate lands within the Area and to produce oil, gas, natural gasoline and associated hydrocarbons, insofar as such terms, covenants and conditions do not relate to the 64 Zone, to the end that no default by any such Participant in the performance of such terms, covenants and conditions not relating to the 64 Zone shall adversely affect in any way or jeopardize the rights of Operator and Participants with respect to the 64 Zone.

Section 2. In the event any Participant shall receive from the owner of any Royalty Interest any notice of default in the performance of any term, covenant or condition of any lease or other instrument under which such Participant is granted the right to develop and operate lands within the Area and to produce Unitized Substances, such Participant will forthwith furnish Operator with a copy of such notice of default and Operator shall, within five (5) days after receipt by Operator of such notice, call a meeting of Participants to consider the action, if any, Operator shall be instructed to take to protect the Unit Operation from any loss by forfeiture or otherwise on account of such default. Participants shall with reasonable promptness determine what, if any, action Operator shall take with respect to such default and shall instruct Operator accordingly. Operator shall have full right to perofrm any instruc-

tions given by Participants as aforesaid, even though such instructions may provide for operations relative to a zone other than the 64 Zone, and on property in which operating rights are held by a Participant who disapproves the instructions given Operator. No action taken by Participants with respect to any notice of default shall release or relieve any defaulting Participant from its obligation hereunder to perform, with respect to formations, zones or strata other than the 64 Zone, the terms, covenants and conditions of such lease, operating agreement or other instrument. Any expenditure authorized by Participants to be made by Operator pursuant to this Section 2, if and to the extent necessitated by a default of a Participant as to a matter not chargeable to the common account, shall be charged by Operator to the defaulting Participant and shall be paid by it on demand, together with interest thereon at the rate of seven per cent (7%) per annum from the date of expenditure by Operator. Operator shall have all rights and remedies for the collection from such Partcipant of such moneys as are provided elsewhere in this agreement for the collection of any moneys from any Participant, including the right to contribution from other Participants.

Section 3. Any Participant shall have the right, at any time, without consulting any other Participant, to surrender and quitclaim any interest held by it in and to lands within the Area other than (a) the right to drill for, develop and produce Unitized Substances, or any thereof, and (b) such surface and other rights and interests as are necessary or convenient to the Unit Operation.

Section 4. Each Participant shall have the right, as provided in Section 3 of Article II, to develop and produce for its own account oil, gas, natural gasoline

and associated hydrocarbons from any and all formations, zones or strata other than the 64 Zone. Any Participant drilling any well through the 64 Zone, or deepening, abandoning, plugging back or completing any well which has been drilled through the 64 Zone, shall take such steps as shall be designated by Participants for the purpose of protecting the 64 Zone. If the Participant conducting such operation is not willing to adopt the specific measures designated by Participants therefor, the protective measures proposed by Participants and those proposed by the Participant conducting such operations shall be referred to the Division of Oil and Gas of the Department of Natural Resources of the State of California, and the decision of that Division shall be conclusive of the matter.

* * * *

ARTICLE X

Payment of Rentals, Royalties and Taxes

Section 1. Each Participant shall pay all rentals, royalties, overriding royalties, and other payments which pertain to or affect lands of such Participant subject to this agreement, including the 64 Zone, and which may be or become payable pursuant to any lease, operating agreement or other instrument to which such Participant is a party by privity of contract or privity of estate, and each Participant shall promptly furnish to Operator, upon demand, a statement that payment thereof has been made. In the event any Participant shall fail to make payment when due of such rentals, royalties, overriding royalties and other payments, and if such failure shall constitute a default permitting termination or forfeiture of the right of such Participant in and to the 64 Zone, Operator may, if it so elects, make such

payment for and on behalf of the defaulting Participant; and Operator shall be entitled to reimbursement therefor from such defaulting Participant, together with interest on any payment so made at the rate of seven percent (7%) per annum from date of payment. Operator shall have all rights and remedies for the collection of such moneys from such Participant as are provided elsewhere in this agreement for the collection of any other moneys from any Participant, including the right to contribution from other Participants. The right of Operator to make any such payment shall be in addition to any and all other rights of Operator pursuant to the other provisions of this agreement.

Section 2. For the tax year 1950-1951 and for each tax year thereafter, each Participant shall prepare and file its returns with the proper taxing authorities covering all real estate (including improvements and mining rights or mineral interests) and personal property owned by it within the Area, excluding, however, Unit Wells and Unit Facilities, and shall pay or cause to be paid the taxes thereon. Each Participant shall furnish to the Operator a statement showing the amount of such payments, supported by copies of tax receipts. Operator shall ascertain the aggregate amount of taxes paid by all Participants with respect to the mining rights or mineral interests in the 64 Zone, provided, however, that if a part of such taxes shall have been assessed to and paid by the holder of a royalty interest, the amount thereof shall, for the purpose of the statement and apportionment hereinafter provided for, be deemed to have been paid by the corresponding Participant. The aggregate amount thereof shall be apportioned among the Participants in proportion to the respective Participating Equities on the assess-

ment date (now being the first Monday in March) for the fiscal year for which said taxes were levied and Operator shall furnish each Participant with a statement showing the amount of such taxes paid by each Participant, the aggregate amount thereof, and the apportionment thereof among Participants. Each Participant who has paid less than the amount apportioned to it shall pay the difference to the Operator, who shall ratably distribute said payment among those Participants who have paid more than the amounts apportioned to them respectively. If said taxes on the mining rights or mineral interests with respect to the 64 Zone are not separately assessed, the Participants shall determine the aggregate amount of the taxes with respect to the mining rights or mineral interests to be allocated to the 64 Zone and such determination shall be the basis for the apportionment provided for in this Section 2. If any Participant fails to make payment of its said taxes with respect to such mining rights or mineral interests, Operator may, if it so elects, make such payment for and on behalf of the defaulting Participant; and Operator shall be entitled to reimbursement therefor from such defaulting Participant, together with interest on any payment so made at the rate of seven per cent (7%) per annum from the date of payment. Operator shall have all rights and remedies for the collection of such moneys from such Participant as are provided elsewhere in this agreement for the collection of any other moneys from any Participant, including the right to contribution from other Participants. The right of Operator to make any such payment shall be in addition to any and all other rights of Operator pursuant to the other provisions of this agreement. Operator shall prepare and file returns with the proper

taxing authorities covering all Unit Wells and Unit Facilities, and Operator shall pay, or cause to be paid, to the proper taxing authorities all taxes levied or assessed against such Unit Wells and Unit Facilities and shall charge such payment to the common account. Operator shall pay all taxes and assessments on or measured by the production of Unitized Substances, including the State Petroleum and Gas Fund assessment, and shall charge such payment or payments to the common amount. The several Participants may collect from the owners of the royalty interests in their lands, by deductions from royalties or otherwise, the share of such taxes for which the owners of such royalty interests are or may be liable under any lease or other instrument without accounting therefor to the Operator or to the other Participants.

ARTICLE XI

Assignments and Transfers; Rearrangement or Revision of Tract Values and Participating Equities

Section 1. Each Participant shall retain the right at any time or from time to time to sell, assign, transfer, quitclaim, surrender or otherwise dispose of, subject to this agreement, its interests, or any thereof, in whole or in part, in or to the lands or any thereof of such Participant in the Area and in or to the Unit Wells and Unit Facilities, provided that no interest in lands with respect to the 64 Zone shall be transferred or surrendered separate from a corresponding interest in Unit Wells and Unit Facilities, or vice versa. If an interest in lands with respect to the 64 Zone shall be transeferred or surrendered, the transferee or person receiving such sur-

render shall be and become one of the Participants under this agreement, and it shall be made a condition of any such transfer or surrender that the transferee or person receiving such surrender or assignment assume in writing, filed with the Operator, all obligations and liabilities hereunder of the transferring or surrendering Participant with respect to the interest transferred or surrendered arising out of or relating to or dependent upon events occurring after the time of such transfer or surrender, and upon the filing of such assumption the Participant so transferring or surrendering such interest shall ipso facto be released and discharged from all such obligations and liabilities so assumed, but shall not thereby be released from obligations and liabilities, if any, under this agreement other than those arising out of or relating to or dependent upon events occurring after the time of such transfer or surrender. No Participant shall surrender or quitclaim any right, title or interest of such Participant in or to the 64 Zone in such a manner or under such circumstances that the tract or tracts of land to be surrendered or quitclaimed shall not remain subject to this agreement following such surrender or quitclaim.

* * * *

ARTICLE XII

Effective Time and Duration

* * * *

Section 2. This agreement, upon becoming effective as provided in Section 1 of this Article XII, shall continue in full force and effect as long as Unitized Substances, or any of them, can be produced from the 64 Zone in quantities determined by Participants to be sufficient to pay to produce; provided, however,

that this agreement may be terminated prior to such expiriation date by the unanimous consent of all Participants.

* * * *

ARTICLE XIII

Miscellaneous

* * * *

Section 2. Each Participant, to the extent of such Participant's Participating Equity share thereof, indemnifies and agrees to hold each other Participant harmless of and from any claim of or liability to any third person asserted upon the ground that operations under this agreement have resulted in or will result in any loss or damage to such third person, to the extent, but only to the extent, that such claim or liability is asserted against such other Participant in an amount in excess of such other Participant's Participating Equity share of such claim or liability; it being the intention of Participants that any claim of or liability to any third person asserted upon the ground that operations under this agreement have resulted in, or will result in, any loss or damage to such third person, shall be borne by all Participants in proportion to their respective Participating Equities. The indemnity provided by this Section 2 shall also cover all costs and expenses, including reasonable attorney's fees, incurred by any Participant in connection with any such claim of or liability to any third person. At the request of any Participant, Operator shall effect collection of the indemnity provided for by this Section 2 from all Participants liable under such indemnity; and Operator shall have all rights and remedies for the collection thereof which are provided elsewhere in this agreement for the collection of other moneys from

any Participant, including the right to contribution from other Participants. Neither the indemnity contained in this Section 2 nor that contained in Section 8 of Article V shall impair the other, and such indemnities, where both are applicable, shall be considered together.

* * * *

Section 9. Each Participant hereby waives the benefit of the provisions of Chapter IV, Title X, Part II of the Code of Civil Procedure of the State of California relating to actions for partition of real and personal property and does hereby convenant with each other Participant that during the existence of this agreement such Participant will not at any time resort to any action at law or in equity to partition the property, or any thereof, owned by Participants as tenants in common pursuant to this agreement.

* * * *

APPENDIX C

Table of Exhibits Pursuant to Rule 18(2)(F) as Amended:

Exhibits	*Identified, Offered and received*
1-A	R. 67
2-B	R. 67
3-C	R. 67
4-D	R. 67
5-E	R. 67
6-F	R. 67
7-G	R. 67

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